



## **Economic Impact Analysis Virginia Department of Planning and Budget**

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### **9 VAC 25-770 – Virginia Financial Responsibility Requirements for Mitigation Associated with Tidal Dredging Projects**

#### **Department of Environmental Quality**

May 9, 2003

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The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

### **Summary of the Proposed Regulation**

The General Assembly allows in Chapter 49 of the 2002 Acts of Assembly that any certificate issued by the State Water Control Board related to dredging projects governed under Chapter 12 and Chapter 13 of Title 28.2 may be conditioned on a demonstration of financial responsibility for the completion of compensatory mitigation requirements.

The proposed regulation specifies mechanisms by which financial responsibility for the completion of compensatory mitigation for tidal dredging projects permitted under the Virginia Water Protection (VWP) permit program can be demonstrated. Under the proposed regulation surety bonds, letters of credit, and certificates of deposit are acceptable financial instruments through which the financial responsibility requirements can be met. The amount of the surety bond, letter of credit, or certificate of deposit is to be based on a cost estimate, approved by the State Water Control Board (SWCB), of implementing the compensatory mitigation project. The

proposed regulation also allows in-lieu fee fund donations and mitigation bank credit purchases as acceptable ways of fulfilling the financial responsibility requirements. The amount of the donation and/or the number of mitigation credits to be purchased is determined by the SWCB. In cases where the U.S. Army Corps of Engineers (USACE) requires bonding to ensure project completion, the amount and the financial mechanism approved by USACE will be considered adequate to meet the financial responsibility requirements of the proposed regulation.

The proposed regulation will replace the emergency regulation in effect since December 4, 2002. A number of changes have been made to the emergency regulation enacted in December 2002, including exempting state and federal government projects from the requirements of the regulation and requiring that proof of having met the financial responsibility requirements be submitted to the SWCB at least 60 days before the onset of any activity in the affected areas.

The proposed regulation also includes additional language clarifying various aspects of the regulation.

## **Estimated Economic Impact**

The proposed regulation specifies acceptable means of financial assurance for tidal dredging projects that require the implementation of compensatory mitigation plans. Such projects are permitted under the VWP program and by the USACE. The financial assurance requirements proposed by the regulation are intended to ensure that permittees have adequate financial resources in order to implement any required compensatory mitigation projects. The requirement for compensatory mitigation is determined by DEQ on a case-by-case basis at the time the VWP permit is issued.

The acceptable forms of financial assurance that meet the financial responsibility requirements for mitigation associated with tidal dredging projects are:

- Financial responsibility is to be demonstrated by a surety bond, a letter of credit, or a certificate of deposit. The amount of the surety bond, letter of credit, or certificate of deposit is to be based on a detailed cost estimate of the compensatory mitigation activities to be undertaken. The proposed regulation provides guidelines for the determination of mitigation cost estimates.

- Financial responsibility can also be demonstrated by donations to in-lieu fee funds and purchase of mitigation bank credits. In-lieu fee funds refer to monetary funds operated by non-profit organizations and government agencies that receive financial contributions from individuals affecting wetlands or streams while conducting an authorized permitted activity. The money so received is spent on providing consolidated compensatory mitigation for wetlands and streams affected by the permitted activity. Mitigation banks refer to sites providing consolidated compensatory mitigation that conform to state and federal laws and are operated under a signed banking agreement. The donations to in-lieu fee funds and/or the purchase of mitigation bank credits are to be made prior to the commencement of any dredging activity in the permitted areas. The amount of the donation and the number of credits to be purchased are to be determined by the SWCB based on a detailed cost estimate of implementing the compensatory mitigation plan. Proof of the donation and/or purchase of the mitigation bank credits are to be submitted to SWCB for approval at least 60 days prior to the start of dredging activities in the permitted areas.
- When the USACE requires demonstration of financial responsibility, the mechanism and amount approved by them will be deemed adequate to meet the requirements of this regulation. Tidal dredging projects generally receive permits for the USCAE and the SWCB. In order to avoid duplication, no additional financial assurances will be required if the USACE already requires such assurances.

All federal and state tidal dredging projects are exempt from the requirements of this regulation, as they are deemed to have the requisite financial strength and stability to meet the financial responsibility requirements being addressed by the proposed regulation.

The Department of Environmental Quality (DEQ) estimates that the proposed regulation is likely to affect fewer than 10 applicants for VWP permits per year. According to DEQ, not all individuals and entities applying for VWP permits for tidal dredging projects will be required to meet the requirements of this regulation as not all tidal dredging projects require compensatory mitigation. For example, dredging projects that only affect non-vegetated areas under surface waters are not required to undertake compensatory mitigation. Thus, only those individuals and entities applying for VWP permits for tidal dredging projects that require a compensatory mitigation will be affected by the proposed regulation.

According to DEQ, there have been a few instances when compensatory mitigation projects have had to be abandoned due a lack of financial resources and/or a lack of clear responsibility. Under these circumstances, DEQ has no way of enforcing the completion of the compensatory mitigation project. The enforcement problem has been particularly acute when multiple property owners have been involved in dredging coves for boating access.

The proposed regulation is likely to have the benefit of providing better enforcement of current policy. Current policy is intended to protect the environment from degradation resulting from dredging in tidal areas. However, the lack of effective enforcement tools may allow some permittees to engage in dredging activities harmful to the environment without undertaking any form mitigation. To the extent that permittees are not implementing compensatory mitigation, they impose costs on the citizens of Virginia, either by degrading the environment or by the state implementing some form of mitigation in order to prevent the degradation. Under the proposed regulation, VWP permit applicants who are required to implement compensatory mitigation under the conditions of their permit will have to present financial assurances guaranteeing adequate resources for the completion of compensatory mitigation before they begin any dredging activities. By requiring financial guarantees at the time the permit is issued or modified, the proposed regulation will ensure that permittees fulfill the terms and conditions under which the VWP permits are issued.

However, the proposed regulation is likely to impose additional costs on VWP permit applicants. In the case of financial instruments such as surety bonds and letters of credit, applicants will be required to pay a risk premium. The risk premium reflects the market's assessment of the risk of the applicant defaulting on compensatory mitigation requirements. For example, if the market determines that certain individuals and entities are more likely to default than others, the risk premium charged to them is likely to be higher than that charged to individuals and entities with a lower default risk. Moreover, requiring VWP permit applicants to meet financial assurance requirements well in advance of when the mitigation is actually carried out could impose further costs. According to DEQ, mitigation projects are usually implemented a year after the permit is first granted. Thus, individuals and entities required to meet the financial assurance requirements are forfeiting income that could have been earned had the money used for in-lieu fee fund donations, bank mitigation credit purchases, and certificates of

deposit been put to other, more lucrative, uses in the time between when the permit is issued and the mitigation project is implemented.

The net economic impact will depend on whether the additional costs imposed by the regulation are greater than or less than the benefits of enforcing existing policy and providing the environment with a slightly greater degree of protection. Mitigation projects for tidal dredging projects cost anywhere between \$4,000 and \$300,000. The additional cost incurred in paying risk premiums and in lost income depend on the market's assessment of the risk of default and the rates of return that could have been earned by these individuals and entities had they invested the money elsewhere. While the data required for precise estimates of these costs and benefits do not currently exist, the costs imposed by the proposed regulation are not likely to be very large. The expected benefits will depend on the number and magnitude of the mitigation projects that would have been abandoned had the proposed regulation not been promulgated. Given that there have been only a few instances of mitigation projects not being implemented, the expected benefits of the proposed regulation are not likely to be very large. Overall, we would expect the economic impact of the proposed regulation to be quite modest.

The proposed regulation also makes a number of changes to the emergency regulation in effect since December 4, 2002. (i) It exempts state and federal tidal dredging projects from the requirements of this regulation as they are deemed to have the requisite financial strength and stability to meet financial responsibility requirements. The proposed change is not likely to have a significant economic impact. There have not been any cases of state and federal compensatory mitigation projects being abandoned due to a lack of resources. (ii) It also requires applicants to submit proof of having met the financial responsibility requirements to the SWCB at least 60 days before the onset of any dredging activity. The emergency regulation required the proof to be submitted prior to the start of any dredging, but did not include a 60-day minimum requirement. The additional compliance requirement was added in order to give DEQ enough time to review the financial assurance documents submitted by applicants. The proposed change is not likely to have a significant economic impact. Even under the emergency regulation, applicants are required to submit financial assurance documents. The difference is that they will now be required to submit it earlier than they might have done otherwise. To the extent that the proposed change allows DEQ to conduct a more thorough review of the submitted documents, it is likely to have a small positive economic impact.

## **Businesses and Entities Affected**

The proposed regulation will affect all businesses and entities required to obtain or modify a VWP permit for tidal dredging projects that require compensatory mitigation. DEQ estimates that the proposed regulation will affect less than 10 applicants per year. These applicants will now be required to demonstrate financial responsibility for the completion of compensatory mitigation requirements at the time the permit is issued.

## **Localities Particularly Affected**

The proposed regulation will particularly affect localities in the Tidewater region.

## **Projected Impact on Employment**

The proposed regulation is not likely to have a significant impact on employment.

## **Effects on the Use and Value of Private Property**

The proposed regulation is likely to impose some additional costs on individuals and businesses seeking to obtain a VWP permit for tidal dredging projects that require compensatory mitigation. They will now be required to demonstrate financial responsibility for the completion of any compensatory mitigation projects required as a condition of their VWP permit at the time the permit is issued. The proposed regulation may increase the cost of operation and hence lower the asset value of some individuals and businesses not currently meeting these requirements.